NATIONAL CONFERENCE OF STATE LEGISLATURES

444 NORTH CAPITOL STREET, N.W. SUITE 515 WASHINGTON, D.C. 20001
202-624-5400 FAX: 202-737-1069
www.ncsl.org info@ncsl.org

TESTIMONY OF

REPRESENTATIVE DAN BLUE
NORTH CAROLINA HOUSE OF REPRESENTATIVES

ON BEHALF OF
THE NATIONAL CONFERENCE OF STATE LEGISLATURES

BEFORE THE HOUSE GOVERNMENT REFORM AND OVERSIGHT COMMITTEE'S SUBCOMMITTEE ON NATIONAL ECONOMIC GROWTH, NATURAL RESOURCES AND REGULATORY AFFAIRS

JULY 28, 1998

Mr. Chairman, members of the Subcommittee. I am Representative Dan Blue, a member of the North Carolina House of Representatives. I appear before you today on behalf of the National Conference of State Legislatures (NCSL). A mere four days ago, I was honored to be elected President of NCSL.

I want to thank you Mr. Chairman for offering NCSL an opportunity to participate in this hearing. The National Conference of State Legislatures represents the state legislatures of the 50 states and the nation's commonwealths and territories. Since its inception, NCSL has been outspoken about the need to maintain and strengthen our federal system of government. State legislators are dedicated to our constitutional system of federalism, strengthening intergovernmental relations, avoiding unfunded mandates and inappropriate grant conditions, encouraging prcgram and administrative flexibility and opposing unjustified preemption of state law.

The cornerstone of NCSL's long-held basic policy on federalism (see attachment 1) states that: "to revitalize federalism, the three branches of the national government should carefully examine and refrain from enacting proposals that would limit the ability of state legislatures to exercise discretion over basic and traditional functions of state government." It is from this foundation that I wish to address the major topic of this hearing--- President Clinton's Executive Order 13083 and federalism generally. I intend to present several recommendations that we believe would enhance the federal regulatory and lawmaking processes and would stimulate greater consultation with state and local government officials on matters of mutual concern.

I - EXECUTIVE ORDER 13083 - THE PROCESS. E.O. 13083 was signed on May 14, 1998. It was developed unilaterally, without consultation with elected state and local government associations or representatives of their associations. It provoked a uniform response from the Big 7, the umbrella body of organizations representing state and local government officials. We have said many times over the past weeks that we are "mystified" and "perplexed" by our exclusion from the process leading up to the promulgation of E.O. 13083. We remain so. To their credit, administration representatives have offered to extend the effective date for implementation of E.O. 13083 for an additional 90 days. This is a good first step. Nonetheless, this offer, standing alone, does not satisfy the three major ingredients of a new policy on "Federalism and Intergovernmental Relations" passed by NCSL last week at its 24th annual meeting (see attachment 2). In no uncertain terms, it is the position of NCSL and the position expressed in a letter from the Big 7 dated July 17, 1998, that:

(a) Executive Order 13083 must be revoked;
(b) its two predecessors, E.O. 12875 (1993, President Clinton) and 126 12 (1987, President Reagan) must be reinstated; and
(c) consultations with elected state and local government officials and representatives of their organizations must be initiated to assess whether there is any need to modify E.O. 12875 and 12612.

RECOMMENDATION #1 - **I urge this subcommittee and members of both the House and Senate to join NCSL and its state and local government counterparts in a collective, bipartisan call for revocation of** E.O. **13083, reinstatement of E.O. 12875 and 12612 and reinstitution of consultations with elected state and local government**

officials on executive orders dealing with federalism and the intergovernmental partnership.

The process followed by the Clinton administration in developing what became Executive Orders 12875 (Enhancing the Intergovernmental Partnership) and 12866 (Regulatory Reform) was exemplary. It was based on a similar process employed by the Reagan administration and its working group on federalism. There are plenty of good examples of how consultations should occur with elected state and local officials. While the "ball has been dropped on Executive Order 13083," this is atypical of the way NCSL and state legislators have been dealt with by this administration

Bear in mind that the process used by the current administration in late 1992 through the fall of 1993 ultimately produced: (a) Executive Order 12875, which expedited the waiver process and was the precursor to enactment of the Unfunded Mandates Reform Act (UMRA); (b) Executive Order 12866, which modernized and enhanced the regulatory cost and benefit analysis guidelines for executive agencies; and (c) the retention of Executive Order 12612, despite the fact that the original effort focused exclusively on reworking that document. To say the least, it was successful and met our expectations.

Furthermore, out of these consultations conducted in 1992 and 1993 with the Clinton administration came the framework for regulatory consultations on implementing welfare reform, children's health, Medicaid programmatic and administrative reforms, safe drinking water amendments and others over the past 24 months. Using the same model of collaboration, we can, together, assess whether there is any need to modify and update executive orders and other documents related to federalism and intergovernmental relations.

II - EXECUTIVE ORDER 13083 - THE SUBSTANCE. Every one of us testifying before you today has closely studied the new executive order and its predecessors. The new executive order incorporates major changes in the process by which federal policymakers interact with state and local elected officials and their associations. It also incorporates major changes in the conditions for preempting state law and authorizing federal action intruding on state authority.

For example, the new executive order offers a list of nine reasons to federal regulators and policymakers to take action overriding state authority. These range from state fears regarding business relocations and state incapacity to make regulatory resources available to compliance with international obligations. Deleted are what used to be separate sections on preemption and, unfunded mandates as well as specific references to the Tenth Amendment. For another example, the new executive order concludes that states OFTEN are uniquely situated to discern the sentiments of the people and to govern accordingly. By comparison, E.O. 12612 affirms that states UNIQUELY possess the constitutional authority, the resources and the competence to discern the sentiments of the people and to govern accordingly.

The administration, in meetings with Big 7 executive directors and in responses to communications from members of Congress, indicates that the drafting of the new Executive Order was prompted by a combination of recent Supreme Court decisions, enactment of UMRA and a need to fortify and continue the expedited waiver process. Not having been at the table and, therefore, without any other framework for responding, it seems that the new executive order is much more than an update. However, the best way to get at the rationale that went into the preparation of Executive Order 13083 is through effective consultation with the administration.

Recommendation #2. Using Executive Orders 12612 and 12875 as the foundation, the administration, in collaboration with elected state and local government officials, should assess the need for changing either of these policies. Together, I trust that we could mutually determine whether a new executive order blending the two documents would be a step forward for federalism and intergovernmental relations.

It is very important that we move expeditiously and collaboratively to address this matter.

III - FEDERALISM - IMMEDIATE OPPORTUNITIES IN 1998. Congress also has a role in improving intergovernmental relations. There are three pieces of legislation now pending before the Congress, two of which would enhance our intergovernmental partnership and a third which NCSL believes would be a step backward.

Recommendation #3. The Congress should enact legislation that will provide a technical correction to the Unfunded Mandates Reform Act regarding scoring by the Congressional Budget Office of entitlements and mandatory programs. The Congress should also enact S. 981, legislation codifying Executive Order 12866.

Regarding the former, language providing for the technical corrections to UMRA was inserted in H.R. 3 534, legislation which has passed the House of Representatives. A similar provision is included in the Senate's companion legislation, S. 389. NCSL wholeheartedly endorses this technical correction. We remain very appreciative to this subcommittee and to many members of Congress who have provided the leadership in curbing unfunded mandates.

I realize that the issue of regulatory reform has drawn much attention during both the 104th and 105th Congresses. As you enter the final weeks of the 105th Congress, it appears that the only legislation enjoying potential bipartisan support that could lead to enactment is S. 981. This legislation would enhance the cost-benefit analysis process of pending and existing regulations and codify President Clinton's E.O. 12866. As written, it contains judicial review provisions. It may not include more far reaching reforms that many of you have advocated, but it would be a significant step forward.

Recommendation #4. The Congress should avoid cutting or constraining various state-federal partnership programs.

The FY 1999 House budget resolution, H.Con Res 284, suggests that significant cuts in Medicaid, children's health and income security programs, namely TANF and the Social Services Block Grant, be imposed. For a variety of reasons, all spelled out in attachment 3, reductions in these programs would undermine aggressive efforts, made possible by enactment of federal legislation, to reform welfare and ensure health coverage for children These reductions would fracture agreements made among federal, state and local officials. They represent a step backward for federalism and intergovernmental relations.

IV - FEDERALISM - DEVOLUTION. Mr. Chairman, over the past four years, notable progress has been made in many issue areas with the restoration of authority to states and the bolstering of federalism. The list is quite impressive: Welfare Reform, the Unfunded Mandates Reform Act, the state Children's Health Insurance Program (CHIP) and long-sought Medicaid reforms of the 1997 balanced budget agreement, the Safe Drinking Water Act Amendments and, most recently, the TEA-21 legislation. All of these have met most of the many tests NCSL applies regarding flexibility, intergovernmental relations, sorting out of responsibilities, mandates and preemption. It has been our objective to sustain these successes during the rule-making processes. With a couple of notable exceptions, the UMRA has tempered the flood of unfunded federal mandates. States are now undertaking the implementation of the children's health program enacted last year. And, we are now entering the third challenging year of welfare reform subsequent to the federal legislation enacted in 1996.

But, there are troubling and disillusioning events occurring that could erode the balance and restoration of authority exemplified above. I speak to major efforts to preempt states regarding health insurance regulation, product liability, medical malpractice, juvenile justice, land use planning, financial services and electric utility restructuring. Federal preemption of state law is a major problem, one that is getting worse not better, despite progress in other areas of intergovernmental relations. The attached article (attachment 4) from NCSL's magazine, State Legislatures, summarizes what we conclude is the competing trends of devolution and counter-devolution.

In all the years I have been in the state legislature and active in NCSL, I continue to be impressed with the overwhelming bipartisan accord we enjoy regarding preservation of state authority. Virtually every issue on the counter-devolution list above has been addressed by most, if not all, state legislatures. It is not at all clear that federal intervention is required. And, while we recognize there may be some instances when national legislation and/or standards are essential even though they would compromise state authority, procedural safeguards must be put in place to ensure that such drastic steps are necessary. In other words, preemption is something we take very seriously.

> **Recommendation #5. Congress should enact legislation authorizing a preemption point of order akin to the** UMRA **point of order.**

It is not our intention to ensnarl the federal legislative or regulatory processes. Rather, we believe it would be beneficial to have a preemption point of order to enhance the understanding of the consequences of preempting state and local government authority and to fortify the stature of the Tenth Amendment. Congress and federal agencies must be better informed about which state laws they are preempting and should much more explicit about the limits on the preemptive effect of federal action. Above all else, the federal government must be held accountable to the public for actions that preempt state law.

V- FEDERALISM - CONSULTATIONS. Much of the early part of my testimony touched on the consultation process with the executive branch regarding federalism executive orders. Let me suggest that future consultations between the House Government Reform and Oversight Committee and the

Senate Governmental Affairs Committee with state and local officials and representatives of their associations on general issues regarding federalism could prove beneficial. It is my experience that we tend to come before you when there is a crisis, such as with E.O. 13083, or a singular piece of pending legislation, such as with UMRA. Just as it is serving in the North Carolina House of Representatives, it is difficult getting a grasp of the big federalism picture in Congress when you are laboring on a myriad of seemingly unrelated issues. I believe it would be worthwhile for us to explore together a potential framework for further discussions.

NCSL has used a similar "consultation" process through a State-Local Government Task Force. I don't pretend that we have remedied all disputes between state officials and their local counterparts. But, we have uncovered ways to sensitize ourselves to each other's concerns and to develop strategies for making public policy and delivering services from which all benefit.

Thank you for offering this opportunity to me to testify before you today. I welcome your questions on the testimony I have provided today.

National Conference of State Legislatures

OFFICIAL POLICY

Federalism

Our American federalism creatively unites states with unique cultural. political, and social diversity into a strong nation. The Tenth Amendment is the cornerstone of constitutional federalism and reserves broad powers to the states and to the people. Federalism protects liberty, enhances accountability and fosters innovation with less risk to the nation. NCSL strongly urges federal lawmakers to maintain a federalism that respects diversity without causing division and that fosters unity without enshrining uniformity.

Individual liberties can be protected by dividing power between levels of government. "The Constitution does not protect the sovereignty of states for the benefit of the States or state governments as abstract political entities, or even for the benefit of public officials governing the States. To the contrary, the Constitution divides authority between federal and state governments for the protection of individuals." New York v. *United States. (1992).* When one level becomes deficient or engages in excesses, the other level of government serves as a channel for renewed expressions of self-government This careful balance enhances the express protections of civil liberties within the Constitution.

By retaining power to govern, states can more confidently innovate in response to changing social needs. As Justice Brandeis wrote: "It is one of the happy incidents of the federal system that a single courageous state may, if its citizens choose, serve as a laboratory; and try novel social and economic experiments without risk to the rest of the country." New *State Ice Co. v. Liebmann,* (1932). It is a suitable role for the federal government to encourage innovation by states. The federal officials should recognize that failure is a risk associated with experimentation and permit states room to act and evaluate without judging prematurely the value of innovative programs. States are inherently capable of moving more quickly than the federal Congress to correct errors observed in policy and can be more sensitive to public needs.

The Supreme Court has sent a strong message to Congress that its powers under the Commerce Clause have boundaries. In *United States v. Lopez,* (1995), *the Court* properly strengthened the hand of states in negotiating the balance of powers. Congress should heed the wisdom of *Lopez* and not exercise its commerce powers without a compelling need to do so. Similarly, the Supreme Court should add to the ability of states to respond to pressing social and economic problems by interpreting the dormant Commerce Clause in a restrained manner sensitive to the powers of states in the federal system.

Responsiveness to constituencies within state boundaries is diminished as the power of the federal government grows disproportionately. Disturbingly, federal constraints upon state action grow even as states are increasingly acknowledged as innovators in public policy. To revitalize federalism, the three branches of the national government should carefully examine and refrain from enacting proposals that would limit the ability of state legislatures to exercise discretion over basic and traditional functions of state government.

NCSL dedicates itself to restoring balance to federalism through changes in the political process and through thoughtful consideration and broad national debate of proposals to amend the Constitution or to clarify federal law that are specifically intended to redress the erosion of state powers under the Constitution. NCSL does not by this policy endorse any specific proposal for or against constitutional change or call for a constitutional convention.

444 North Capitol Street, N.W. • Suite 515 • Washington, D.C. 20001 • (202) 624-5400

National Conference of State Legislatures

OFFICIAL POLICY

FEDERALISM AND INTERGOVERNMENTAL RELATIONS

(Adopted July 2 I, 1998)

During the past decade, federal officials have been guided by three executive orders, E.O. 12612 (1987), E.O. 12866 (1994) and E.O. 12875 (1993) on matters of federalism and intergovernmental relations. Each of these was promulgated pursuant to consultation with elected state and local government offkials and their associations. These executive orders have emphasized constitutional federalism and the need to preserve state authority, to avoid preemption, to avoid unfunded mandates, to promote administrative and programmatic flexibility, to expedite program waivers, to assess regulatory costs and benefits, and to ensure an effective consultation process. These executive orders have deferred to state and local government sovereignty, authority and capacity to address public policy matters other than those explicitly described as the federal government's powers in the U.S. Constitution. These orders have played a significant role in defining how officials from all levels of government should interact when determining how to implement public policy.

President Clinton signed a new executive order on federalism, E.O. 13083, on May 14, 1998. It changed two of its predecessors, E.O. 12875 and E.O. 12612. It was promulgated without any consultation with any elected state or local government official or their associations. E.O. 13083 promotes a regime of directives and guidance on preemption, mandates, balance of power and division of responsibilities and consultation woefully and disturbingly weaker than its predecessors.

Therefore, the National Conference of State Legislatures believes that E.O. 13083 should be immediately withdrawn.

The National Conference of State Legislatures further believes that the President and representatives of his administration should meet with elected state and local government offkials and representatives of their associations to assess whether there is any need to amend or modify any part of E.O. 12612 and 12875.

The National Conference of State Legislatures further believes that any executive order on federalism and intergovernmental relations should explicitly acknowledge constitutional federalism as spelled out in the 10th and other amendments to the U.S. Constitution as well as the basic structure of the U.S. Constitution itself These executive orders should, at a minimum, explicitly acknowledge that (1) federal action should not encroach upon authority reserved to the states; (2) preemption of state law should occur only when there is clearly a legitimate national purpose and federal law explicitly calls for preemption; (3) unfunded federal mandates should be both discouraged and avoided; (4) maximum program and administrative flexibility for state and local governments is needed to create effective public policy solutions and (5) federal regulatory policies and executive orders affecting the intergovernmental partnership should not be promulgated without effective consultation with elected state and local government officials and their associations.

Attachment 3

NATIONAL CONFERENCE OF STATE LEGISLATURES

444 NORTH CAPITOL STREET, N.W. SUITE 515 WASHINGTON, D.C. 20001
202-624-5400 FAX: 202-737-1069

RICHARD H. FINAN
PRESIDENT OF THE SENATE
OHIO
PRESIDENT, NCSL

ANNE C. WALKER
CHIEF CLERK-ADMINISTRATOR
MISSOURI HOUSE
STAFF CHAIR, NCSL

WILLIAM POUND
EXECUTIVE DIRECTOR

June 16, 1998

The Honorable Pete Domenici, Chairman
Senate Budget Committee
United States Senate
Washington, D.C. 20510

Re: Conference on the Budget Resolution

Dear Senator Domenici:

Ten months ago, the National Conference of State Legislatures hailed the balanced budget agreement and budget reconciliation legislation passed by the U.S. Congress. The agreement balanced the federal budget while preserving the integrity of the intergovernmental fiscal system and strengthening the state-federal partnership. Proportionate spending reductions were achieved, with limited new cost shifts to states and without reliance on new unfunded mandates. As well, the agreement repaired existing cost shifts to states.

As you head to conference committee on the House- and Senate-passed FY1999 budget resolutions, NCSL strongly urges you to maintain the policy path you charted with your historic budget actions last year. To accomplish that, however, will require resisting several stated and implied recommendations that could easily unravel last year's accomplishments. Among the issues with which state legislators are most concerned are the following:

(1) Preserving the full integrity of the Temporary Assistance for Needy Families Block Grant (TANF). In 1996, state and federal policymakers agreed to forego the decades-old AFDC entitlement program in exchange for capped, guaranteed funding for TANF. This agreement also included a related commitment regarding the Social Services Block Grant. Both the Senate and House Budget Resolutions would break that agreement. Most egregious, H Con Res 284 calls for an unacceptable $10 billion dollar cut to income security programs--most likely in the form of a massive TANF reduction.

(2) Preserving the funding levels for the Medicaid program agreed to in the Balanced Budget Act of 1997. We oppose additional reductions in the Medicaid program. Through the enactment ofthe State Children's Health Insurance Program (CHIP), growth in Medicaid enrollment was both anticipated and deemed desirable by the Congress. States anticipate growth in Medicaid enrollment as a result of outreach effort states will implement as part of their children's health insurance programs. Reductions in the Medicaid program at this time would send a mixed message to states and the nation's children.

(3) Preserving the state-federal administrative partnership regarding Medicaid and Food Stamps. The House and Senate budget resolutions and the President's budget arbitrarily reduce federal funds for state administration of Medicaid and food stamps. These recommendations add up to an unfunded mandate. NCSL is more than willing to meet with you to explore administrative modifications if you are convinced that too much is being spent for these functions. Until that occurs, however, we must insist that any administrative funding reductions be accompanied by similar reductions in administrative responsibilities.

Denver Office: 1560 BROADWAY SUITE 700 DENVER, COLORADO 80202 303-830-2200 FAX: 303-863-8003

Furthermore, states are just now embarking on implementing last year's state children's health insurance plan and a number of modifications to the Medicaid program enacted as part of last year's budget agreement. It is completely inappropriate to suggest reducing Medicaid administrative funds when it is the federal government's expectations for states to successfully implement these modifications and the new children's health program.

Additionally, recent enactment of S. 1150, the agricultural research legislation, concluded with Congress manipulating states' food stamps administrative monies, an unfunded mandate that NCSL vigorously opposed from the outset.

(4) Preserving the funding levels for the Social Services Block Grant at the levels agreed to in federal welfare reform legislation or $2.38 billion per annum. The recently concluded conference on transportation legislation (TEA-21) takes over $2 billion out of the Social Services Block Grant, despite our agreement. The transportation legislation also reduces state flexibility regarding transfer of funds between TANF and SSBG. This expanding menu of modifications is fanning a growing distrust of federal intentions regarding welfare reform.

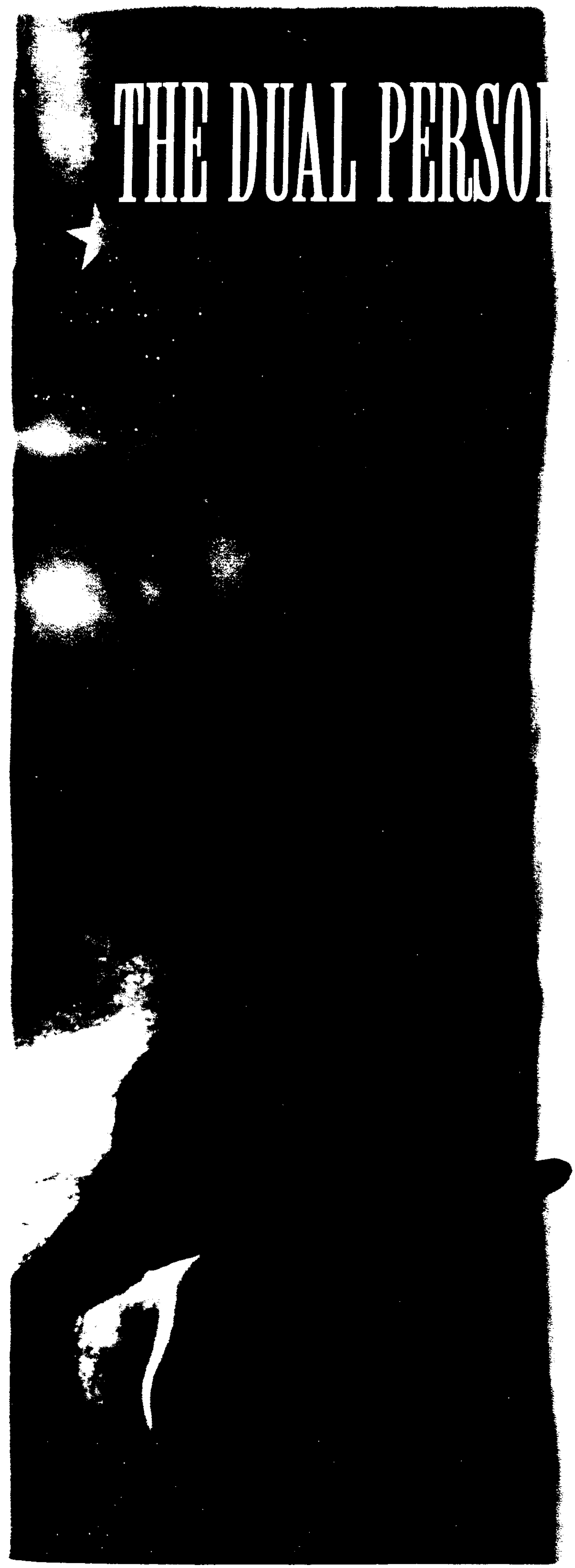
The ISTEA reauthorization conference agreement notwithstanding, the SSBG has provided states with flexibility to fulfill a wide array of social services purposes. Its achievements are well documented. In many regards, it is the purest block grant on the books. To tamper with its authorized funding levels, part of the welfare agreement we all shook hands on, is to confirm the deepest suspicions of those who are not favorably inclined toward block grants. NCSL is an ardent advocate for block grants. We believe block grants can serve national purposes by promoting efficiency and reducing administrative burdens. But, when actions are proposed to reduce the federal commitment to them, it certainly dampens our enthusiasm for seeking other program consolidations that would seem to have merit.

(5) Preserving the level of domestic discretionary spending incorporated into last year's budget agreement. In 1997, congress agreed, on a bipartisan basis, to a five-year spending plan that put you on the path to balance. That agreement produced savings from a wide variety of sources. It met NCSL's major test that savings be achieved on a proportionate basis. H Con Res 284, in particular, deviates dramatically from the balanced budget agreement by seeking deep cuts in both domestic discretionary and state-federal mandatory programs. S Con Res 86, with which we have more modest disagreements as described above, essentially adheres to the bipartisan consensus reached on future spending. We urge you to honor last year's agreement and follow the outline established in S Con Res 86 in conference.

As always, we are willing to work with you as you seek to reconcile differences between S Con Res 86 and H Con Res 284. We again urge you to take a strong stand for retaining the full integrity of the state-federal fiscal and program partnership exemplified in the points we raise. For additional information, please have your staff contact Michael Bird or Gerri Madrid in NCSL's Washington, D.C. office.

Sincerely,

Richard Finan
Senate President, Ohio
NCSL President



Attachment 4

"The Dual Personality of Federalism"

States may be the laboratories of democracy, but the federal government thinks that it knows best. It hardly ever does.

By Carl Tubbesing

This has been a Dr. Jekyll and Mr. Hyde decade for state governments. The Dr. Jekyll side of the 1990s has gotten more publicity. This is the side of the decade's personality defined by devolution, flexibility and more responsibility for state legislatures. Dr. Jekyll has presented the states with landmark devolution legislation: most prominently, welfare reform, a new safe drinking water act, the children's health program and Medicaid reforms.

The Mr. Hyde aspect has received less attention. Preemption of state authority and centralization of policymaking in the national government characterize this half of the decade's dual personality. It restricts state options and promotes uniformity. The Mr. Hyde half has preempted state authority over telecommunications policy, federalized criminal penalties and given the federal government more responsibility for regulation of banks.

Dr. Jekyll is devolution. Mr. Hyde is counter devolution. Devolution trusts state officials and relies on them to be responsive and responsible. Counter devolution says state boundaries are archaic. Devolution subscribes to Justice Brandeis' premise that states are laboratories of democracy. Counter devolution raises the question, "Are states really necessary?"

The devolution trend may have lost momentum. (Only new legislation on work force training and surface transportation pending this year would continue devolution.) On the other hand, there are at least a dozen proposals before Congress this year that have the potential for more preemption and greater centralization in Washington of policymaking.

Is there something about the last decade of the 20th century that is accelerating the trend toward preemption? Yes and no. There are five primary explanations of why federal officials propose to preempt state activity. Two of these are more or less unique to the 1990s. Three, however, are permanent components of the preemption debate.

PREEMPTION BECAUSE OF TECHNOLOGY

There is no doubt that technological advances have altered the way the country conducts its business and the way people communicate. The Internet, computer networks, cellular phones and all of their technological and telecommunications cousins have shrunk the world. They ignore state boundaries, present daunting challenges to state regulatory schemes and tax structures, and tempt federal officials to supplant state regulation

Carl Tubbesing is NCSL's deputy executive director.

and taxation with national approaches.

Turn on your computer. Get on the Internet. Access the Barnes and Noble home page. Type in your Visa number. Order a hundred dollars worth Of books. Do you pay your state and local sales tax? probably not. Get in your car and drive to the mall. Go into Barnes and Noble and buy the same books. Do you pay your state and local sales tax? Absolutely.

Sign up with America Online. Pay the monthly fee. Do you pay a local government Internet access tax? Maybe, but probably not. Decide that you want to be the first in your neighborhood to use on-line telephony. Do you pay the telecommunications tax? Now, that's a really tricky one.

"Electronic commerce poses a long-term threat to the current tax system. The threat is that consumers will increasingly use electronic media for purchasing goods and services-circumventing conventional sales taxation," writes Thomas Bonnet-t in Is the New Global Economy *Leaving State-Local Tax Structures Behind?* State legislators are only just beginning to grapple with the tremendously complex and politically charged questions of whether and how to tax transactions on the Internet.

Federal officials are concerned about how state and local governments will tax the Internet. Some, like California Congressman Christopher Cox, Oregon Senator Ron Wyden and the Clinton administration, worry that any rush by state and local governments to tax it will stifle a burgeoning new industry and dampen economic activity. Senator Wyden argues that taxation of Internet activities would prevent "small high-tech businesses from prospering."

Wyden and Cox are pushing federal legislation that would prevent state and local governments from enacting new Internet taxes for six years. They argue that a lengthy moratorium is necessary to give the industry a chance to grow and to provide time for government and industry officials to work out a systematic approach. North Dakota Senator Byron Dorgan, a former state tax commissioner, strongly opposes the Cox-Wyden bill. "Federal preemption is inappropriate," he says. "The federal government should keep its nose out of the states' business."

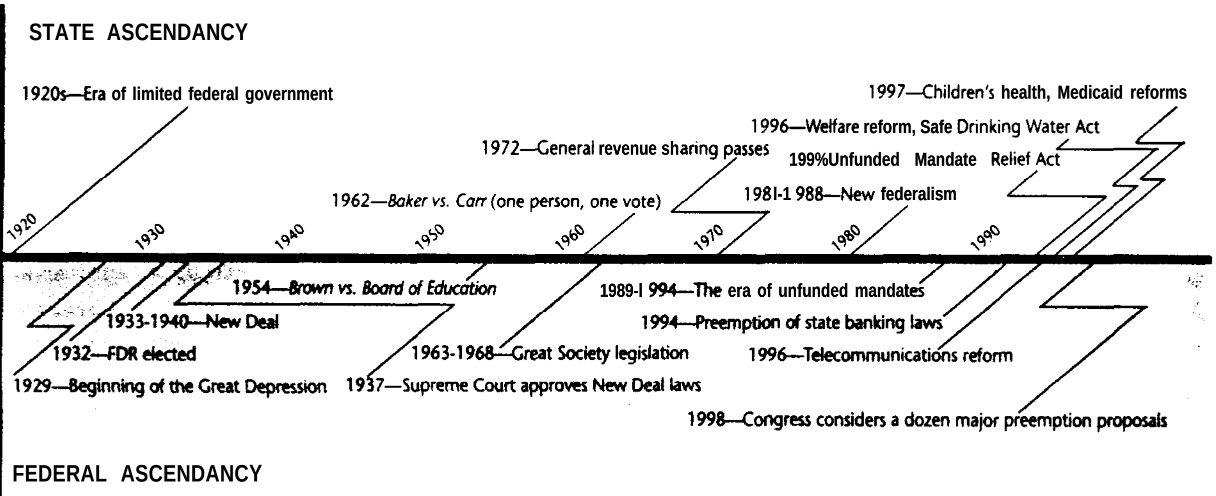
Technology, combined with a dramatically evolving economy, also explains federal attempts to preempt State regulation of the banking and insurance industries. State legislatures initiated the revolution in financial services industries in the 1980s when they began allowing interstate banking. In 1994, Congress approved the Riegle-Neal bank reform bill that largely substituted federal interstate branch banking rules for the ones states had developed. Legislation to modernize banking pending before this session of Congress would further erode state control of financial services. The bill, whose chief sponsor is House Banking Chairman Jim Leach, would limit states' regulatory authority over insurance and securities.

Iowa Congressman Leach argues that technology and the changing financial services marketplace make state regulation of the industry virtually obsolete. In a March 1997 speech before the Institute of International Bankers, the Banking Committee chair argued: "The global financial services industry is evolving at a rapid pace, and legislation is needed in part to reflect marketplace changes, in part to set the ground rules for the next generation of change."

The Office of the Controller of the Currency, an executive branch agency, has made similar arguments in a series of recent rulings that have eroded the ability of states to regulate banking and insurance.

Despite the changing financial marketplace, defenders of state banking and insurance laws argue that state regulation is necessary to ensure a financial system that makes the most sense for each state. "Banking needs in Arkansas are just not the same as they are in New York," says Arkansas Representative Myra Jones. She fears that "continued nationalization of banking will prompt the exodus of investment capital from certain states, especially rural ones."

Since 1932 American federalism has largely been an era of predominance of the federal government in establishing domestic policy. The 1990s, marked by passage of legislation devolving some responsibilities to state governments, have seen some reversal of this trend. At the same time, the federal government also has taken authority away from the states in several key areas.



PREEMPTION AND POLITICS

Congressional politics have changed over the past decade. There are more competitive congressional districts. And congressional campaigns are becoming more and more expensive. It is plausible to argue that both of these developments have exacerbated the congressional tendency to propose legislation that would preempt state authority.

According to American Enterprise Institute scholar Norman Ornstein, congressional elections have become more competitive in the 1990s. More seats are changing parties from election to election. There are greater fluctuations in election margins. (An incumbent may win with 60 percent of the vote one year, then lose two years later.) And the number of safe seats has come down from the high mark of the 1988 election.

More competition presumably means that congressional candidates are actively on the lookout for issues that will appeal to voters. They need popular ideas that set them apart from their opponents. What better place to look than state legislatures?

For several years, legislatures have responded to consumer concerns about managed care. According to NCSL's Health Policy Tracking Service, 32 states have adopted legislation that gives patients in managed care direct access to OB/GYNs. Twenty-six legislatures have passed laws requiring that insurers cover emergency care. Recognizing the popularity of these and similar laws, Georgia Congressman Charles Norwood has introduced comprehensive legislation to regulate a variety of managed care practices. If approved, Norwood's bill would preempt all state legislation in this area.

The 1997 gubernatorial race in New Jersey drew national attention to consumers' concerns about the costs of automobile insurance. Since the 1970s, 15 state legislatures have attempted to control insurance costs by adopting no-fault laws. Kentucky Senator Mitch McConnell, asserting that "the nation's auto insurance system desperately needs an overhaul," has introduced legislation in the 105th Congress that would preempt state laws and impose a national no-fault system.

State legislatures have responded in various ways to consumer complaints about fees that banks charge for using automatic teller machines. A few have banned the fees altogether. A few others have required banks to inform customers that they will be assessed a fee for using the machine. Bills currently pending in Congress copy these two approaches. New Jersey Congresswoman Marge Roukema takes the warning message approach. New York Senator Alfonse D'Amato would ban the fees. Either would preclude state regulation and variations among states.

The cost of running for Congress has continued to rise in the 1990s—substantially more than the rate of inflation. A cynic might link the increase in preemption proposals to an incumbent congressman's nearly insatiable need to raise campaign funds. Some legislative and regulatory proposals, which almost coincidentally preempt state authority, are worth billions of dollars to companies. The companies naturally marshal their lobbying resources in support or opposition to the bills and favor their congressional allies with political donations.

A cynic might link the increase in preemption proposals to an incumbent congressman's nearly insatiable need to raise campaign funds.

In 1995, the New Hampshire legislature became the first in the nation to restructure electric utilities. Since then, nine other legislatures have approved similar legislation. In 1996, Colorado Congressman Dan Schaefer introduced legislation that proposes to impose national deregulation and to preempt state efforts. Such a massive change in the electric industry would be worth millions, if not billions, of dollars to companies affected by restructuring. For example, the Edison Electric Institute, a trade association for investor-owned electric utilities, opposes federal mandates that would require states to restructure. Enron, a power marketing company, supports such federal action.

It is not surprising, therefore, that campaign contributions from companies in this fight have increased dramatically since Congressman Schaefer first introduced his bill. For example, Enron and its PAC in 1993 reported soft money contributions to the various congressional campaign committees and the two national parties of $47,000. By 1995, this figure grew to $120,000. And in 1996, the year the deregulation bill was filed, Enron's soft money contributions totaled $286,500—a sixfold increase in three years.

Contributions to individual congressmen also increased in this period. Congressman Schaefer chairs the Energy and Power subcommittee of the House Commerce Committee. Campaign contributions from energy companies to Congressman Schaefer, for example, went up following introduction of his bill. In 1993-94, Schaefer reported contributions from energy companies and associations of 525,806. They increased by almost $10,000 for 1996-97—once the bill was introduced.

Comprehensive national legislation to reform telecommunications, which passed in early 1996, also attracted substantial donations to congressional campaigns and the national Political Parties. A 1996 Common Cause study found that "local and long distance telephone companies gave their biggest political donations ever during the last six months of 1995." The bill, which South Dakota Senator Larry Pressler called "the most lobbied bill in history," preempts state authority over the telecommunications industry and sets the conditions for entry of Bell companies into the long distance telephone market

Certain congressional committees may be popular among members because of the issues with which they deal and their link to campaign contributions. Membership on the House

Banking Committee has grown by five since the beginning of the current biennium. The Bureau of National Affairs attributes this to the committee's jurisdiction over financial modernization legislation-proposals that would preempt state authority. "It is a bonanza in terms of PAC funding," says an unnamed source for the BNA story. "The issue before the Banking Committee pits the banking lobby against the securities lobby, the insurance lobby. It's a committee that naturally attracts major PAC funding. This is cne of the richest PAC mines." And apparently a rich source of preemption.

PREEMPTION AND DIVERSITY

In the late 1970s, the National Conference of State Legislatures and the State Government Affairs Council cooperated on a project on "purposeless diversity." Legislators and private sector representatives attempted to identify policy areas in which uniformity among states was desirable. The project's premise was that some kinds of diversity impose costs on the private sector and, therefore, have a dampening effect on the economy. Like many things, though, purposeless diversity is in the eye of the proverbial beholder. Debate in the federal government over'preemption often centers on whether uniformity is warranted in order to reduce private sector costs.

For a decade or more, Congress has considered legislation that would preempt state product liability laws. Proponents of preemption in this area argue that a national product liability law would reduce business costs and, therefore, improve the competitive position of American businesses. In testimony before the Senate Commerce Committee in 1993, Alabama Representative Michael Box asserted that these arguments are "specious" and lauded the advantages of a civil justice system that allows states to fine-tune their laws in response to changes within each state. Representative Box summarized by saying that "uniformity has no greater intrinsic value than the value of self-government by states."

In 1996, Congress approved product liability legislation. President Clinton vetoed it, however. During 1997, West Virginia Senator Jay Rockefeller shuttled between the White House and Capitol Hill in an attempt to find a compromise. New product liability legislation could surface again during the 1998 session.

THE TOP TEN PREEMPTION PROPOSALS FOR 1998

There are at least 10 proposals pending in Congress and the administration this year that would preempt state authority.

Electric Utility Deregulation Since 1995, 10 legislatures have chosen to deregulate the electric utility industry. Many others have considered restructuring and have rejected it or decided to defer it. Proposed congressional legislation would impose a national solution.

Tobacco Settlement The agreement reached between state attorneys general and the tobacco industry would preempt state law in several areas-product liability, smoking in public places, sales to minors and others. Preemption in the agreement is viewed as a concession state officials would make in exchange for settlement funds--and to achieve a national goal of reducing smoking, especially among teenagers. Most of the bills introduced in Congress as versions of the settlement would also substantially preempt state authority.

Juvenile Justice Last spring, the House passed juvenile crime legislation, sponsored by Florida Congressman Bill McCullom, that continues a trend toward federalizing crime and criminal penalties. For example, it would force states to try as adults juveniles accused of violent crime. Similar legislation is pending this year in the Senate.

Tax Reform All of the major proposals to revamp the federal tax code-whether a national sales tax, a flat tax or changes to the income tax-have consequences for state tax systems. The consequences include explicit or implicit preemption of state tax laws and a significant impact on state revenues.

Internet Taxation Bills offered by California Congressman Christopher Cox and Oregon Senator Ron Wyden would place a moratorium on state and local taxation of activities conducted over the Internet. Early versions of the legislation might have rolled back many existing and traditional taxes, including those on sales and property. Later rewrites would preclude only imposition of new taxes on Internet activities.

Child Care President Clinton wants to make affordable child care available to more people. He has resisted calling for national standards that would govern child care providers. Children's advocates want national standards, which would preempt state control. So far, they have not garnered much support in Congress.

Product liability For at least a decade, Congress has considered bills that would substitute federal rules of law for state product liability laws. In 1996, Congress, for the first time ever, was able to agree on federal product liability legislation. After lengthy debate in the White House, President Clinton vetoed the bill. Congress was unable to override the veto. Several members of Congress, led by West Virginia Senator Jay Rockefeller, tried during 1997 to find a compromise acceptable to both the president and Congress.

Takings Many state legislatures have wrestled with the complex and controvenial questions associated with property rights and the taking clause of the Fifth Amendment to the Constitution. The U.S. House last year passed legislation that would remove certain aspects of property rights matters from the purview of the states. The Senate is taking up similar legislation in 1998, sponsored by Georgia Senator Paul Coverdell and Utah Senator Orrin Hatch.

Financial Services Financial modernization legislation, whose chief advocate is Iowa Congressman Jim Leach, would remove firewalls between banks and other financial services, such as insurance and securities. In the process, it would preempt all state laws that currently govern the relationship between banks, insurance companies and the securities industry.

Managed Care Georgia Congressman Charles Norwood is the principal sponsor of legislation that would regulate a wide range of managed care practices-for example, the length of maternity stays, access to emergency services and access to specialists. If approved, the bill would preempt state activity in this area.

THE FIVE HALLMARKS OF **DEVOLUTION** IN THE 1990s

The election of Bill Clinton, a former governor, to the White House in 1992 and the Republican takeover of Congress in 1994 created an atmosphere congenial to turning responsibilities over to state legislators and governors. The phenomenon known as devolution funds programs through block grants, rather than categorical funding. It gives state officials greater flexibility for designing programs. It loosens some of the strings that the federal government traditionally has attached to grant money. And it substitutes options for cumbersome, "father knows best" federal waiver processes.

Unfunded Mandate Reform Act **Ohio Senate President Richard Finan has called unfunded mandates "the most powerful symbol of the imbalance in the federal system." Unfunded mandates, he said in a 1997 speech, "represented the exact opposite of how our federal system is supposed to work. Decisions were being made at the national level and paid for one or two levels below that."**

Passed in early 1995, the Unfunded Mandate Reform Act marked the beginning of the devolution era. The act has three key elements. It set up a unit in the Congressional Budget Office to develop cost estimates on mandates. It has a strong point-of-order procedure, which gives any member of Congress the right to question an unfunded mandate on the floor. And it requires all federal agencies to prepare an analysis of any new regulation that will cost more than $100 million.

Welfare Reform **The sweeping 1996 welfare reform law is the centerpiece of devolution. It substitutes a block grant, called Temporary Assistance for Needy Families, for the old entitlement program, Aid to Families with Dependent Children. State officials accepted lower and constrained funding levels for flexibility in designing and running programs. The law stresses moving welfare recipients into jobs. It eliminates the onerous federal waiver process that state officials formerly had to follow to experiment with their own approaches. It is not totally lacking in mandates and penalties. (State legislators have especially railed against its very prescriptive child support enforcement section.) Yet its key elements form the mantra of devolution: more flexibility, more responsibility and more choices.**

Safe Drinking Water Act **The old Safe Drinking Water Act epitomized the "command and control" approach to federal-state relations common in the 1980s. The old law was an effective rallying point for the campaign against unfunded mandates. Why, cried legislators, mayors and governors, must a city in Nebraska test its water for a pesticide that is used only on pineapples in Hawaii? State legislators, governors and local officials were instrumental in passage of the new Safe Drinking Water Act, which removed many of those unfunded mandates. Approved in 1996—at almost the same time as the welfare reform law-the new drinking water law also establishes a state revolving loan fund for construction of drinking water capital projects.**

Medicaid Reforms **The budget bill approved last August codified an agreement between congressional leaders and the president to balance the budget by 2002. (Current predictions are that the budget may be balanced by FY 1999.) The act is a comprehensive combination of tax cuts, spending increases, spending cuts and program changes. Among the program changes are two that continue devolution. The first is a set of alterations to Medicaid that give state officials greater flexibility in running this expensive program. State legislators can now decide to use managed care in their Medicaid programs without applying to the federal Health Care Finance Administration for a waiver-waivers that formerly might be approved, might be denied, but without fail took many months, and sometimes years, to process. Legislators also now have more flexibility in determining cost reimbursement. The new budget act repeals the Boren Amendment, which Medicaid providers had used in court to compel states to reimburse them at higher rates.**

Children's Health Insurance **The budget balancing act also initiated the most significant change in national health policy in a decade or more. The children's health insurance program allocates $24 billion over five years to states to provide coverage to children who are currently uninsured. State legislatures have considerable flexibility under the new law for choosing among coverage options and setting benefit levels.**

PREEMPTION AS A CATCH-22.

Some advocates Of specific preemption proposals argue that states have not done enough in the area. Proponents of others point out that most states have already acted, so why shouldn't the federal government step in and finish the job? State legislatures are damned if they do, damned if they don't.

In the damned-if-they-do category are some of the federal proposals to regulate managed care. If 41 states already ban the use of so-called gag clauses in communications between managed care doctors and patients, then, proponents ask, what's the harm in having a national law' But federal intrusion precludes additional experimentation and the adjustments that legislatures make as thev gain experience with new laws.

In the damned-if-they-don't category this year is child care. President Clinton has made new child care legislation one of his top four or five initiatives for 1998 The administration so far has resisted pleas from some children's advocates to fight for national standards. The advocates argue that these standards are necessary because they believe many current state laws and regulations are inadequate to protect the safety of children.

PREEMPTION AND NATIONAL IMPERATIVES

Occasionally, achieving a national goal overrides concern for state authority. In these instances, preemption is nearly a coincidental effect of the desire to accomplish a compelling national objective. The Voting Rights Act of 1965, for example, substituted federal law for state laws in order to end discrimination. Federal air quality law supplants state laws and regulations because air does not recognize state boundaries, and states, acting on their own, cannot reduce pollution.

The national tobacco settlement and proposals to reform the federal tax system are good current examples. The tobacco agreement, reached among 41 state attorneys general and the tobacco industry, is intended to accomplish several objectives. It would reduce smoking, especially among children and adolescents. It would reimburse states for past and future medical costs for patients with smoking-related illnesses. And it would limit the tobacco companies' liability from at least some financial and legal claims. At the core of the agreement is a trade. The companies agreed to pay $368.5 billion over 25 years, $193.5 billion of which would go directly to the states, States, in turn, would accept federal preemption of state tort law. The attorneys general also agreed, in part to satisfy anti-smoking activists, to preemption in several other areas, including laws regarding smoking in public places, a minimum smoking age, vending machine sales and other retail practices. The settlement must be codified with federal legislation.

Several members of Congress, including Massachusetts Senator Ted Kennedy, Utah Senator Orrin Hatch, North Dakota Senator Kent Conrad and Arizona Senator John McCain, have introduced bills offering their versions of the settlement. Each would preempt state authority.

Proposals to reform the federal tax system have received more attention in the past several months, especially now that it appears the federal budget will be in balance within the year. Some would change elements of the current income tax structure. Others would scrap the income tax in favor of entirely different taxes. Texas Congressman Bill Archer, House Ways and Means chair, and Louisiana Congressman Billy Tauzin have different national sales tax proposals. House Majority Leader Dick Armey advocates a flat tax. The goals of these reformers include simplifying taxes, mitigating inequities and eliminating an unpopular tax. Any of the proposals, however, have consequences for state revenues and state tax codes, including preemption.

THERE ARE SOLUTIONS

State legislators and governors are working to find ways to draw attention to the problems posed by preemption and to minimize the number of federal bills and regulations that supplant state authority. Meeting in November 1997, representatives of NCSL. the National Governors' Association, the American Legislative Exchange Council and the Coun-

cil of State Governments agreed to a set of "federalism statutory principles and proposals." The proposals are patterned in part after elements of the Unfunded Mandate Reform Act and are designed to place procedural obstacles in the way of attempts at preemption. The groups are now working to generate support in Congress and the administration for such a measure.

Current controversies over preemption and centralization reach back to the drafting of the Constitution, to the early days of the United States, and the debates between Alexander Hamilton and James Madison-differences that led to the formation of the first political parties in this country. They no doubt will continue into the next millennium.